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The new case for increased railroad rates

[Philadelphia]

[1914]

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The new case for increased railroad rates; abstracts of testimony and arguments presented to the Interstate commerce commission, by railroads in Official classification territory in the rehearing of the 5 per cent. advance rate case, October, 1914. [Philadelphia, 1914]

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"The presentation of the case on behalf of the carriers was in charge of a committee of railroad presidents, comprised of Daniel Willard (chairman), president, Baltimore and Ohio railroad company, Samuel Rea, president, Pennsylvania railroad company, A. H. Smith, president, New York central lines."

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Abstracts of
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Presented to the
Interstate Commerce Commission

By Railroads in
Official Classification Territory in the Rehearing
of the 5 per cent. Advance Rate Case,
October, 1914

The New Case for Increased Railroad Rates

Abstracts of
Testimony and Arguments
Presented to the
Interstate Commerce Commission

By Railroads in
Official Classification Territory in the Rehearing
of the 5 per cent. Advance Rate Case,
October, 1914

"The needs of the carriers are pressing and immediate, . . . and the actual condition . . . has become extremely critical."

MR. DANIEL WILLARD,
in presenting the case of the railroads to the Interstate Commerce Commission on October 19, 1914.

"The abnormal conditions brought about by the war affecting so directly the ability of any borrower to secure new capital, and requiring forcible reduction of all expenses and husbanding all resources, are strong reasons for remedying, at least in part, and doing so as quickly as possible, the fundamental unsoundness—war or no war—that had been previously shown to exist in the railroad industry."

MR. SAMUEL REA,
in presenting the case of the railroads to the Interstate Commerce Commission on October 23, 1914.

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ON July 29, 1914, the Interstate Commerce Commission handed down its decision denying the application of the 35 railroad systems in Official Classification territory for an increase of 5 per cent. in freight rates. Certain exceptions were made on behalf of the railroads in Central Freight Association territory.

On September 15, 1914, Mr. Daniel Willard, as Chairman of the Presidents' Committee, filed with the Commission a petition for the modification of the order of July 29th, so as to permit the carriers to make effective all the rates involved in a general application for a 5 per cent. increase.

The presentation of the case on behalf of the carriers was in charge of a Committee of Railroad Presidents, comprised of

DANIEL WILLARD (Chairman),
President, Baltimore and Ohio Railroad Company

SAMUEL REA,
President, Pennsylvania Railroad Company

A. H. SMITH,
President, New York Central Lines

Acting for the Presidents was a Committee of Counsel, as follows:

HUGH L. BOND, JR.,
General Counsel, Baltimore and Ohio Railroad

GEORGE F. BROWNELL,
Vice-President and General Solicitor, Erie Railroad

J. L. MINNIS,
General Solicitor, Wabash Railroad

O. E. BUTTERFIELD,
Assistant General Solicitor, New York Central Lines

GEORGE STUART PATTERSON,
General Solicitor, Pennsylvania Railroad Company

The hearings were held in Washington on October 19th to 23d, inclusive, and the case was argued before the Commission on October 29th and 30th. The following pages contain summaries of the more important facts and considerations which the railroads sought to bring to the attention of the Commission.

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Testimony and Arguments

General Statement of Reasons for Now Asking Advance in Freight Rates

WASHINGTON, D. C.,
October 19, 1914

Mr. Daniel Willard, President of the Baltimore and Ohio Railroad, opened today before the Interstate Commerce Commission the case of the Eastern railroads for higher rates.

Mr. Willard is Chairman of the Committee of Railroad Presidents having in charge the presentation of the railroad case. His statement summarizes the general facts upon the basis of which the railroads maintain that the Commission should now allow the general increase of 5 per cent. in freight rates.

Mr. Willard said:

"The railroads operating in Official Classification Territory, and parties to the so-called 'Five Per Cent. Case,' now appear before this Commission as petitioners and respect-

fully request that such modification be made of the Report and Order of July 29, 1914, as will enable the carriers to put into effect the rates which were therein directed to be cancelled.

"Subsequent to the filing of the Report and entry of the Order of the Commission in the cases known as Docket No. 5860 and I. & S. Docket No. 333, facts and circumstances have arisen which could not possibly have been foreseen upon the date when the Order was entered. A war of unprecedented proportions has broken out, and this, taken in connection with the facts already in the record, with such additional information as the carriers are now able to furnish, clearly indicates such a situation as your petitioners believe fully justifies the relief now prayed for.

"The tariffs above referred to were originally filed by the railroads in October, 1913, and are intended to provide for a general advance, with some exceptions, of approximately 5 per cent. in all freight rates in Official Classification Territory. In support of the advanced tariffs the carriers pleaded, among other things, inadequacy of revenues, and the Commission in its report on July 29th used these words:

> "'In view of a tendency toward a diminishing net operating income, as shown by the facts described, we are of opinion that the net operating income of the railroads in Official Classification Territory, taken as a whole, is smaller than is demanded in the interest of both the general public and the railroads, and it is our duty and our

> purpose to aid, so far as we legally may, in the solution of the problem as to the course that the carriers may pursue to meet the situation.'

"It should be kept in mind that the words just quoted were written previous to the 29th of July, 1914, and before it was possible to foresee or weigh the great events which have transpired since that date. However, with such facts before it as were developed in the original record, and in furtherance of its announced purpose to aid so far as it legally might in the solution of the problem then confronting the railroads, the Commission approved of certain rate advances in Central Freight Association Territory, and suggested the propriety of other advances and changes of practices which, if found practicable, would inure in varying degree to the advantage of all of the roads involved in this proceeding.

"The carriers are not unmindful of the great significance of the words just quoted from the Commission's report in this case, and they do not doubt that, with the assistance of the Commission, additional net revenue may eventually be obtained along the lines suggested, and definite action has already been taken concerning many of the subjects referred to, and all are receiving earnest consideration, but the needs of the carriers are pressing and immediate, and the measures of relief proposed by the Commission will not in our opinion adequately meet the existing situation.

"In order that the Commission may intelligently consider the whole subject as affected

by present conditions, it would seem necessary to supplement the original record with such additional facts and figures as are now available, showing operating results of these carriers since the case was submitted on May 29th. The railroads, in support of their claim of inadequate revenue, filed statements showing the result of their operations for a term of years to June 30, 1913, and in its report the Commission considered also the monthly statements of the railroads up to and including the first eleven months of the year ended June 30, 1914. The carriers are now able to furnish complete reports for the entire fiscal year of 1914, and we desire to offer this additional and supplementary evidence, believing it to be essential to a proper determination of the case.

"The combined statements of all the railroads involved in this proceeding for the fiscal year ended June 30, 1914, show roundly that the total operating revenues during that year were approximately $48,000,000 less than during the previous year, while the operating expenses during the same period were approximately $22,000,000 greater. The net operating income of these companies for the same period amounted to $260,000,000, or approximately $76,000,000 less than was earned during the previous year, and equal to but 3.98 per cent. upon the property investment, a lower return than was shown at any time in the preceding fifteen years. The income, applicable to interest, dividends and surplus during the fiscal year just closed was $265,700,000, or 4.06 per cent. upon the total capital obligations, this return also being lower than any in fifteen years. The operating figures for July and August have been

tabulated and will be presented to the Commission, and they also serve to emphasize the tendency toward diminishing net income, which the Commission found in the facts in the record as originally submitted.

"The carriers by documentary evidence and witnesses, if desired, are prepared to support the general statements just made.

"While the additional figures now submitted clearly establish a continuation of the recognized tendencies toward a diminishing net income, the actual situation which confronts the railroads today, as revealed by the information now available, and because of the unforeseen and unprecedented events which have taken place since July 29th, has become extremely critical. The problem is no longer one of tendencies, but has become instead one of actual reality.

"A war such as that now raging causes great and immediate disturbance to industry, commerce and finance. It causes contraction of credit and great restriction, if not the actual stoppage of international trade as well as serious disturbance to domestic commerce, and, as we have seen, it has thrown the security markets of the world, first into panic and then into suspension of operations. These have, in fact, been the immediate, direct and clearly apparent consequences of the war which began less than three months ago; but the ultimate and more lasting consequences are almost as plainly to be seen and will certainly follow, if they do not accompany, the conditions mentioned. These are enormous destruction of wealth, with great diversion of labor and capital to unproductive employment, thus causing a check to the world's accumulation

of new capital, and a serious and prolonged rise in the rate of interest. The effect of such higher interest rates will continue long after the present emergency has passed, because they will be reflected in the basis upon which the new securities will be issued from time to time as required, for refunding and other purposes; and in so far as the war and its consequences tend, as I have just shown, to change the conditions surrounding the enlistment of new capital, they tend to change the fundamental relation between railroad and shipper.

"The cost of capital is one of the important elements of the cost of transportation.

"It is known that the railroads of the United States have over $520,000,000 of outstanding obligations which will mature and must be met within the next twelve months alone, and it was shown in the original record in this case that the railroads in Official Classification Territory only had spent approximately $200,000,000 per annum upon their properties for improvements and extensions during the last ten-year period, and it will be necessary to continue such expenditures if the roads are to maintain their standard of service and provide for the growing needs of the future. Further, as nearly as can be ascertained, there are more than $3,000,000,000 par value of American railroad securities held abroad as investments. The demands for cash in Europe, growing out of the present situation, will doubtless result in large selling of such securities when the markets or exchanges are again opened, and the possible effect of such selling upon railroad credit and related subjects is causing much concern.

"With all this in mind it will readily be

seen that the available supply of and probable demand for new capital, as well as the interest rates thereon, are matters of great importance, not only to the railroads, but also to those who depend upon them for transportation, and in our opinion a proper determination of this case cannot be made unless these matters as affected by existing conditions be given full consideration. I shall not dwell further upon this important phase of the question, however, because others who are deeply interested in the subject have asked to be heard in that connection.

"The case of the railroads, as so frequently pointed out, is quite unlike that of a private undertaking. The railroad, because of its public character and the terms of the charter under which it is permitted to operate at all, is subject to governmental regulation, not only as to the charges which it shall impose, but also as regards many of the details of operation, and on that account is unable, like the private enterprise, to readjust its rates and practices to meet such a situation as now exists unless and until the necessary approval is obtained.

"Finally, it is respectfully submitted that whatever the outcome as concerns these railroads might have been, had there been no war, as a matter of fact there is a war and a grave emergency now exists. It is hardly necessary to suggest that if the Commission, in view of the present situation, should now conclude, after consideration of all the facts, to approve the tariffs as requested, and should it at any time later on appear that the situation had changed and the emergency had passed, and should it further appear that the carriers involved in this proceeding were

then, taken as a whole, in such condition as to earnings, maintenance charges and return on capital obligations as to justify a reconsideration of the action now prayed for, this Commission would have ample power to order at any time such reductions as might be fair and reasonable, and I am of opinion that the carriers would not oppose such action by the Commission when conditions such as I have enumerated shall have been established."

Financial Condition of Eastern Railroads

WASHINGTON, D. C.,
October 19, 1914

The specific differences in the financial situation of the thirty-eight Eastern carriers now as compared to one year ago, when the 5 per cent. rate advance was first requested, were presented to the Commission by Mr. George M. Shriver, Vice-President of the Baltimore and Ohio Railroad. Mr. Shriver is Chairman of a Committee of Accounting Officers appointed to compile data for the railroads as a whole. Mr. Shriver's figures covered the period to June 30, 1914.

"A striking feature of the 1914 returns," said Mr. Shriver, "is the complete disappearance of surplus or margin."

The figures presented showed that the railroads in this territory paid in 1914 average dividends of 4.58 per cent., but

that they fell short by $8,200,000 of earning that dividend—itself the lowest rate of dividend paid in ten years. The year 1914 was the first year in fifteen years in which these railroads earned no surplus over the dividends paid.

For the three Systems generally considered prosperous, viz., the Pennsylvania, the New York Central, and the Baltimore and Ohio, the surplus or margin after an average dividend of 5.53 per cent., was only $461,235. In 1913 it was $47,083,000 and had averaged $38,733,000 for fifteen years.

In the previous case special attention was called to the fact that whereas all the roads concerned in this proceeding had in the three years ended June 30, 1913, invested $660,000,000 in their properties, the net operating income in 1913 was $16,300,000 less than for 1910, before the $660,000,000 had been spent.

Mr. Shriver presented figures today showing that during the past year these same roads had invested $249,000,000 additional in their properties, and yet their net earnings were $70,500,000 less than for 1913. In other words, in four years $909,000,000 had been invested in these properties, and yet on June 30, 1914, these companies were $87,500,000 worse off in net operating income that they were before the $909,000,000 had been spent.

Operating revenue in 1914 was $1,375,000,000, less by $48,000,000 than in 1913, although operating expenses (notwithstanding the smaller amount of business handled)

were $22,000,000 more than in the previous year.

While the business handled in 1914 was, excepting 1913, the largest in fifteen years, the net operating income was the smallest shown in ten years.

Taxes increased $2,900,000 in 1914. These railroads paid $22,000,000 in taxes in 1900; they paid $57,000,000 in 1914—an increase of 159 per cent.

The taxes paid by the three larger Systems were $33,400,000 in 1914, an increase of $2,180,000 over 1913. These same companies paid but $12,200,000 in 1900—an increase for the period of 173 per cent.

For the Pennsylvania, the New York Central, and the Baltimore and Ohio, net operating income in 1914 was $41,476,000 less than in 1913, and the lowest in ten years.

Dividends paid by these three Systems were smallest in five years and at the lowest average rate for ten years.

In 1914, for the three Systems, the sum available for interest, dividends and surplus amounted to but 4.54 per cent. on total capital obligations, a rate much the lowest of any shown in the preceding fourteen years. Previous to 1914 the ratio did not fall below 5.67 per cent.

The Financial Condition of the Pennsylvania System

WASHINGTON, D. C.,
October 19, 1914

Data concerning the Pennsylvania Railroad System filed with the Interstate Commerce Commission in connection with the application for increased freight rates show that the net income from operations was lowest for the fiscal year ending June 30, 1914, for any year since 1904.

Since 1904 the Pennsylvania Railroad System has invested $549,193,847 in additional railroad facilities, but in 1914 the System's net income from operations was only $5,481,799 greater than it was before the $549,193,847 had been spent, an amount equal to less than 1 per cent. on the increased investment.

The net operating income of the Pennsylvania System was not only less in 1914 than in any year since 1904, but actually less than in 1902. In 1902 the System's total operating revenues were $208,752,224; in 1914, total operating revenues were $369,925,303. During these twelve years the Pennsylvania System increased its gross business by $161,173,000, and yet in 1914 its net income from its operations as a whole were

less by $324,847 than they were before this increase of 77 per cent. in total business had been realized and before $627,448,020 additional money had been put into the property.

The Pennsylvania System earned last year 5.79 per cent. on its total capital obligations of $1,263,385,873. That was the lowest ratio of income to total capital obligations for the last fifteen years, and lower than 1898 and 1899, which the Commission stated were years of depression. The Property Investment account of the Pennsylvania Railroad System is now $1,448,165,228. On this sum the System earned last year 4.48 per cent., the lowest ratio in the last fifteen years.

The total property investment of the Pennsylvania Railroad System exceeds its total outstanding capital obligations in the hands of the public by $184,779,355.

After paying expenses, taxes, fixed charges and dividends, the Pennsylvania System had for the fiscal year 1914 a surplus of $10,417,531, and out of a total operating revenue of $369,925,303, a surplus of 1.68 per cent. on capital stock was available for other corporate purposes.

This surplus was the lowest in the last fifteen years, and was less than one-half of the surplus realized in all but two of the fifteen years.

As compared with the year 1913, the Pennsylvania figures for 1914 show:

Total capital obligations increased $32,247,025.

Property investment increased $61,232,251.

Total operating revenue decreased $12,520,911.

Total operating expenses decreased $4,249,754.

Net operating revenue decreased $8,271,157.

Tax accruals increased $794,317.

Net operating income decreased $11,153,864.

The Financial Condition of the New York Central and the Baltimore & Ohio Railroad Systems

WASHINGTON, D. C.,
October, 19, 1914

Figures covering the operations of the New York Central Lines filed with the Interstate Commerce Commission in connection with the application of the Eastern railroads for an increase in freight rates showed that net operating income of that System for 1914 was less than it had been in any year since 1906.

In 1906 the New York Central Lines handled a business from which they received earnings of $217,150,770, and their net operating income was $52,305,096.

Since 1906 the New York Central Lines have added $443,629,000 to their investment in railway property. Using these additional facilities, they were able to handle a business in 1914 yielding gross operating revenues of $295,659,093. This was an increase of $78,509,000 over the business of 1906. But owing to increased operating expenses, taxes, etc., net operating income in 1914 was less by $6,102,000 than it was with the much smaller gross business of 1906, and before the $443,600,000 had been spent for increased facilities.

The New York Central System earned in 1914 but 3.56 per cent. on all of its capital obligations. Its earnings on property investment were 3.29 per cent. Both these ratios were the lowest for any year in the past fifteen.

Taxes, on the other hand, were higher than for any year in the past fifteen, and the ratio of expenses to revenue—78.03 per cent.—was higher than in any year of the past fifteen.

After paying rentals, interest on bonded debt and meeting other interest obligations, the New York Central System realized in 1913 a net corporate income of $40,370,472, but in 1914 this sum was reduced to $9,875,897.

In 1913, after paying dividends, the System carried forward a surplus of $20,563,844, out of total earnings of $310,000,000. In 1914, after paying dividends of approximately $2,000,000 less than in 1913, the System had no surplus whatever left, but in order to pay the dividend specified, was compelled to draw on the surplus of previous years to the extent of nearly $8,000,000.

The year 1914 was the first in fifteen years when the New York Central System failed to earn a surplus over its dividends.

* * * *

The Baltimore & Ohio Railroad System

Data submitted by the Baltimore and Ohio Railroad System in the case of the Eastern railroads for increased freight rates show that the net operating income

of that company was lower than in any year since 1902, excepting the panic year 1908. It was lower by over three million dollars than for 1913.

In 1902 the Baltimore and Ohio realized total operating revenue of $62,584,670. Its net operating income was $21,573,341.

In the twelve years 1902 to 1914 this System added approximately $146,000,000 to its property investment, and in 1914 its gross earnings were slightly over $100,000,000, or about $38,000,000 more than in 1902.

Nevertheless, in spite of this increase in property investment of over 37 per cent. and the increase in gross business of 55 per cent., the System's net operating income in 1914 was almost exactly one million dollars less than in 1902, before the added investment of $146,000,000.

On its total capital obligations the Baltimore and Ohio earned 4.12 per cent. in 1914, while on its property investment it earned but 3.84 per cent. Both ratios were the lowest of any year in the past fifteen.

After paying interest and dividends in 1913, the Baltimore and Ohio carried forward a surplus of $2,081,000 out of a gross operating revenue of $104,000,000. In 1914, however, after paying dividends slightly less than those of 1913, the System had no surplus whatever left, but in order to pay its dividends was forced to draw on the accumulated surplus of previous years by nearly $2,000,000.

Railroads "Going Backward"

WASHINGTON, D. C.

Summing up the situation which he thinks calls for urgent relief for the railroads if they are to keep pace with the growth of business and provide enlarged facilities, as recommended by the Interstate Commerce Commission in its decision in the Eastern case, Daniel Willard, chairman of the Presidents' committee, presenting a plea for reconsideration of that opinion, told the Commission on October 20th, in redirect testimony, that the roads are not meeting the standard prescribed.

Upon this phase of railroad conduct he quoted the Commission in its decision, which said: "The public interest demands not only the adequate maintenance of existing railroads, but a constant increase of our transportation facilities to keep pace with the growth and requirements of our commerce."

"I simply wish to be recorded as having stated under oath," said Mr. Willard, "that in my opinion, with the understanding which I have of the railroads involved in this proceeding, they are not as a whole today being adequately maintained; they are not conforming to that condition which the Commission set up as a desirable standard, nor are they making proper provisions for the constant growth which they may expect.

"I wish also to state that, in my opinion, based upon such knowledge as I have of the business and of the conditions of these carriers, when we shall again be confronted with a condition of business activity, as we may reasonably expect in the not distant future, the railroads in this territory, unless they are in some way put in such position as to justify them to immediately begin to provide facilities, will fall short of being able to take care of the business to a much greater extent than occurred in 1907.

"It should be kept in mind all the time that if the railroads are not adding to their facilities, they are going backward. It is a matter of common knowledge today that the railroads are not buying freight cars, they are not buying locomotives, they are not providing additional facilities; constantly locomotives and freight cars are wearing out. The Baltimore and Ohio has actually fewer cars today than it had two or three or four years ago. It is true they are of higher capacity, but that would more than be made up by the increased business that would be offered.

"If the condition which the Commission set up in its report is a right one, and I most certainly think it is, the railroads today are failing to meet those requirements, and they will not be able to meet them unless some method is prepared or authorized which will permit the railroads forthwith to so add to their net revenues as to enable them to do the things that they are not able to do.

"In my opinion the plan heretofore sug-

gested by the Commission falls short of giving such adequate relief as is necessary. Whether it would have given adequate relief or not had the situation not become as serious as it is now, it seems to me it is not necessary to discuss, because the situation is as it is. But we have already found, and I think it will be clearly shown, that when we report what we have tried to do along the lines that the Commission has suggested, that we are not able to realize the amount of relief which I think the Commission thought we might, and it will take a much longer time to accomplish what we are able to do than was expected in the first instance."

In reply to an inquiry from Commissioner McChord as to whether or not he thought the 5 per cent., or approximately $50,000,000, asked will enable the railroads to keep abreast with development, Mr. Willard said that, to the contrary, the amount of additional revenue which would be secured from the increase "will be quite inadequate to meet the situation."

Continuing, he said: "I do not think the 5 per cent. added now would do it. Probably it would not be $50,000,000 on the present basis, but to speak of it roundly as $50,000,000, in my opinion it would not enable us to do the things that we ought to do, to maintain our railroads as they ought to be maintained and provide such facilities for the future as we ought to provide."

"The notion has gone abroad," continued Commissioner McChord, "that it will not only put the railroads on their feet, but put the country on its feet; is that your notion?" Mr. Willard retorted that he had not argued for the country at all.

"The country seems to be arguing in favor of this," went on the Commissioner. "I see it in the papers and from the petitions that we get here from every quarter of the country."

This brought out the reply that if the railroads found themselves in position to go ahead with their repair and maintenance program, it would undoubtedly stimulate some kinds of business.

Railroad Securities Maturing in 1915, 1916 and 1917

WASHINGTON, D. C.,
October 30, 1914

Illustrative of the significance of the claim of the railroads that the difficulties of securing new capital and of refunding old issues will be greatly increased as a result of the war in Europe, the Eastern railroads have filed with the Interstate Commerce Commission a statement of the aggregate amount of securities maturing during the fiscal years ending June 30, 1915, 1916 and 1917, respectively, for those railroads now asking an increase in freight rates.

These railroads alone must pay off or refund a total of $537,000,000 during the next three years.

* * * *

Of this amount, $325,000,000 are represented by short-time notes, debentures and plain bonds. Of mortgage bonds, $26,000,000 will mature; of collateral trust bonds, $62,000,000; of equipment obligations, $92,000,000; of receivers' certificates, $30,000,000.

Maturities in 1915

By far the greater portion of these maturities will become due before June 30, 1915, the total amount which must be refunded by that time being $320,000,000, of which, $220,000,000 are notes, debentures and plain bonds.

Out of $537,000,000 due by all of these railroads, $303,000,000 represent obligations of the three so-called typical systems, namely, the Pennsylvania, Baltimore and Ohio, and New York Central Systems. These companies alone must pay off $174,000,000 before June 30, 1915, and of this amount, $156,000,000 is represented by short-time notes, debentures and plain bonds.

Condition of Railroads in the Middle West

WASHINGTON, D. C.

Data filed with the Interstate Commerce Commission in the new Five Per Cent. Rate Advance case shows that in the fiscal year 1914 the railroads in the Middle West increased their investment in road and equipment by $45,964,000. Yet such was the reduction in earnings and the increase in expenses, that the net operating revenue was less by $35,000,000 than for the previous year and was the smallest since 1905.

For the roads in Group III* the net operating income was practically cut in half as compared with the previous year, and was by far the smallest in ten years.

*"Group III embraces 28 companies which operate 19,416 miles, or 54.1 per cent. of the entire mileage of the territory. It includes all the mileage in the territory except that of the 'four main trunk line connections,' the 'coal and ore roads,' the 'forty-six short roads' and the 'excluded mileage' (the B. & O. and Erie, C. B. & Q., etc.), and embraces all the mileage which serves generally the people of the territory, and whose prosperity is dependent upon the territory."

—Quoted from evidence of W. C. Maxwell, in five per cent. rate advance case decided July 29, 1914.

"These lines in our opinion are representative of local conditions in that territory."

—Quoted from opinion, page 397, of Interstate Commerce Commission in five per cent. rate advance case decided July 29, 1914.

These roads earned $270,000,000 gross, but such were expenses and taxes that only $19,391,324 remained as net operating income, this being a loss of $19,299,824 from the previous year.

Although 1.86 per cent. less business was handled in 1914, expenses increased $10,698,654 over 1913, and taxes increased $1,197,892.

Other features of the data submitted concerning these roads in Group III are the following:

Total property investment in 1914 was the largest in the history of these companies.

Operating revenue was less than in 1913, but otherwise the largest in the history of the group.

Operating expenses were the largest in their history.

The ratio of operating expenses to operating revenue in 1914 was 84.48 per cent., being 5.45 per cent. over 1913, and much the highest ratio yet experienced.

* * * *

The net operating revenue was the smallest shown in the past 12 years.

* * * *

Taxes in 1914 were $11,826,898, an increase of $1,197,892 over 1913. This item was $6,746,000 in 1903, showing an increase in each succeeding year.

Net operating income in 1914 was $19,391,324, a decrease of $19,299,824 compared with 1913, and was by far the smallest in ten years.

Net corporate income showed a deficit of

$16,007,093 in 1914 as compared with a surplus of $3,683,443 in 1913.

* * * *

Dividends paid were $7,711,156, a decrease of 25.44 per cent. from 1913, and were the smallest in the period 1903 to 1914. The average rate on capital stock was 1.36 per cent., also the lowest rate.

In 1914 the ratio of net operating income to property investment was only 1.29 against 2.61 in 1913—this ratio also being the lowest in any of the twelve years.

This ratio was much lower in 1914 than in the years which, as pointed out by the Commission, were years of "Dullness and inactivity," namely, 1904, 1908 and 1911, when it was respectively 3.84 per cent., 3.16 per cent. and 3.14 per cent.

Since 1910 Group III has had no unappropriated surplus, but a deficit now amounting to $72,080,529. The figures for the past few years are:

1910	$2,094,034 Surplus
1911	18,574,927 Deficit
1912	28,180,578 Deficit
1913	49,741,649 Deficit
1914	72,080,529 Deficit

Eastern Railroads' Losses in Earnings in July and August

The railroads in Eastern territory now applying for an advance of 5 per cent. in freight rates have filed with the Interstate Commerce Commission detailed statements of their operating results for the first two months of the fiscal year 1915. These figures show a loss in operating income for these two months as compared with the same months of the last fiscal year amounting to $271,190 and a loss as compared with the same months of 1913 of $9,878,000.

Total earnings are less than 1914 by nearly $15,000,000, and operating expenses have been reduced by almost precisely the same amount.

The loss in gross revenues for the two months is represented by a reduction of $9,966,000 in freight, and $4,246,000 in passenger earnings.

Effect of Advances and Reforms Suggested by the Interstate Commerce Commission

WASHINGTON, D. C.,
October 27, 1914

In reference to the suggestion of the Interstate Commerce Commission that the carriers increase their revenues by other than a general advance of 5 per cent. in freight rates (estimated by the carriers to yield perhaps $50,000,000 in gross earnings), the railroads have presented to the Commission an estimate as to the possible revenue which may result from advances and reforms allowed and suggested by the Commission in its opinion handed down July 29th, and which the carriers plan to put into effect.

This statement shows that, assuming gross business to remain as it was in the fiscal year 1914, the railroads in this territory will gain from these advanced freight rates and reforms in practice revenues amounting to approximately $9,000,000, or 1 per cent. of the gross freight revenues of all the carriers which originally joined in the application for the 5 per cent. advance and from the advances, present and

proposed, in passenger rates about $3,000,000.

The statement embodying this estimate, presented on behalf of the carriers by Mr. O. E. Butterfield, Assistant General Solicitor of the New York Central Lines, in substance was as follows:

Assuming that all the proposed modifications of rates in Central Freight Association territory are made and that business continues in relatively the same volume, the Erie Railroad estimates that the 5 per cent. advance allowed in Central Freight Association territory will yield to it $79,000 per year in revenue, and that the proposed advance in passenger rates will yield the Erie $130,000.

The Pennsylvania Lines East of Pittsburgh estimate that advances in commodity rates will yield $401,000, reforms in practices $170,000, and that increases in Central Freight Association territory which were permitted to extend over into Trunk Line territory will yield $106,000, thus making a total of $677,000 per annum for the Pennsylvania Lines East of Pittsburgh, or 4-10ths of 1 per cent. of their gross freight revenue.

The Baltimore and Ohio estimate a total increase of $1,246,200, including the 5 per cent. advance in Central Freight Association territory, the advance on commodities and reforms in practice.

The Pennsylvania Lines West of Pittsburgh estimate that the increases allowed or suggested will amount to $1,300,000 per annum, or 1½ per cent. of their gross freight revenue.

Adding together these estimates, and taking the percentage which the gross revenues of these lines bear to the gross freight revenues of the entire territory, it is found that the entire advance allowed by the Commission and contemplated in these reforms will, if the rates are made effective, yield about $8,000,000 per year, or 1 per cent. of the gross freight revenues of all carriers in Official Classification territory.

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Advances in Passenger Rates

The advances already made and contemplated in passenger fares, some of which are quite remote in point of being published, are estimated to yield for the entire territory $3,000,000 per annum.

In connection with the passenger advance, the loss in gross revenue by reason of the practical cessation of the immigrant business, will amount to a sum far in excess of this $3,000,000.

Effect of the War on Railroad Finances

WASHINGTON, D. C.

Testifying before the Interstate Commerce Commission as an expert concerning financial conditions as affected by the European war, and particularly as related to American Railroad securities, Mr. Charles A. Conant, of New York, author of many authoritative works on finance, said in part:

"(1) The cost of the war, if it lasts approximately a year, will not be materially less than $15,000,000,000.

"(2) The demand for capital for purely war purposes, and for the settlements which succeed the war, will be so great as to absorb an amount equal to the entire savings for investment made in all civilized countries for a period of several years.

"(3) The effect of this abnormal demand for capital, which is being consumed without economic profit, will be to raise the rate of interest on investment securities higher than it has been for many years.

"(4) The fact that such enormous sums to pay the costs of the war are sought almost exclusively by means of Government loans will make it impossible to obtain capital for other purposes, except at a rate of interest considerably higher than that paid by governments.

"(5) The financial disturbances which will occur during the process of distribution of these Government loans to investors, extending over several years, will involve the sale on the American market of railway and industrial securities now outstanding to an amount which will in itself absorb so much of the new capital available in the United States, that it will be extremely difficult to obtain any for new enterprises.

"(6) If, therefore, American railways and industrial enterprises are to obtain any new capital whatever, during the next few years, it will be necessary to make issues of securities very attractive, not only in respect to the rate of interest, but in respect to the evidence that the interest and dividend payments are absolutely secured by adequate earnings."

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Mr. Conant quoted authorities indicating that the world's new capital normally available for investment amounts to about $4,000,000,000 per year. He then concludes:

"If the cost of the war for one year has to be paid out of the amount of annual savings indicated by these figures, then every dollar of new capital for approximately four years will be absorbed in

Government loans, and there will not be a penny available in any financial market for building a railway spur, putting up a new station or terminal out of capital account, adding a bobbin to the equipment of woolen and cotton mills, or making a single public improvement in the city of New York or any other municipality, except out of current revenue.

"What part the railways will be able to play in wresting a portion of the world's savings from the outstretched hands of the powers which have been blowing away thousands of millions in powder and ball becomes an interesting consideration. They must come into the open market and bid against the greatest states in the world for some scanty portion of the supply of investment capital.

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"The rise of the return on capital to a new rate and the corresponding fall of prices of securities to a lower level are facts which are apparently inevitable. It should be possible, however, to so distribute the shock of the descent that quotations on the exchanges should oscillate around this new center of gravity instead of plunging violently below it even temporarily.

"Leaving aside the question of averting panic, the most important question involved in the return of American securities held abroad is the manner in which it will diminish the fund of capital which is normally available for new investments. In this direction the effect of the European war loans will be acutely felt in this country,

even if not a dollar of American money appears as a bidder for the new loans.

"It has been recently calculated by Sir George Paish, the economic adviser of the British Government, that the total amount of foreign capital invested in the United States is $6,000,000,000. He also estimates that foreign capital, chiefly British, is invested in Canada to the amount of about $3,500,000,000, and in other American countries, including all Latin America, to about $10,000,000,000.

"It is these enormous sums in foreign holdings which represent the most serious menace to the American market and to the possibilities of our future financial development. This money has been advanced to us from time to time over a long period, because there was not a sufficient fund in America to meet the requirements of our development.

"The newer States of the West could never have been equipped with railways, banks, grain elevators, barns and homes, if foreign capital had not been poured into them in hundreds of millions after our Civil War. What will be involved, in effect, if European investors undertake to market a large part of their holdings of American securities in New York, will be the conversion of this gigantic time loan, payable only over long terms of years, into a call loan, payable as rapidly as the securities can be sold on the New York Stock Exchange. It would hardly be within the range of the capacity of the banking system of the country to absorb the entire amount of $6,000,000,000,

estimated by Sir George Paish to represent foreign investments in the United States.

"The amount in such securities which is returned to the American market will influence directly the amount of investment capital remaining in the United States available for other purposes. It is at this point that the problem comes directly home to American railway managers and their bankers.

"If the country is subjected to a severe strain in order to take back from European holders an amount of securities representing the fund usually available for investment for one year or for several years, there will be practically no surplus left for investment in new railway issues.

"Here again, a question of vital importance will be how far the issues can be made attractive, not only in the rate of interest paid, but in the surplus of earnings above the operating expenses and existing fixed charges of the issuing company, which will give a complete guaranty of security to the new investments."

Beneficial Effect of Increased Freight Rates on Business Conditions

WASHINGTON, D. C.,
October 21, 1914

Reasons why it is important for the general welfare of the country that the prices of railroad securities be maintained, and especially so in view of the existing international financial crisis, were presented to the Interstate Commerce Commission in a statement by Mr. Frederick Strauss, of the Investment Bankers' Association of America. Mr. Strauss was a member of the Railroad Commission of which President Haley of Yale was Chairman, appointed by President Taft to inquire what Congressional action was desirable to place the issuance of railroad securities on a better basis. Mr. Strauss was asked in particular to state what effect the closing of the stock exchanges of the world had upon the existing situation. Mr. Strauss said, in part:

"The closing of the stock exchange, of course, has resulted, for the time being, in checking, or, if not checking, diminishing the tendency toward the exportation of

gold, because, if the European investor is going to sell his securities in this market we shall have to pay for those securities in gold or in trade and commodities. The commodities are moving out, anyway. Now, the gold, of course, would follow to the extent that we cannot ship commodities. It is the reopening of the Stock Exchange, rather, that is going to have a deleterious effect on the whole economic situation.

"England recognizes the importance of maintaining on a reasonable price level, and is now considering (and Sir George Paish told me that it is extremely likely that this will be done) the advisability of a government guarantee to English banks and bankers, in order to induce them to continue carrying existing loans on the present pledged security.

"England has been very conservative in extending governmental aid to private industry, but she finds herself compelled now to do this in order to prevent the utter collapse of the entire credit structure of the world. England's problem, anyway, is comparatively easy, for though England is at war and has all those difficulties to meet, she is a creditor nation. Gold naturally flows to her whenever capital is withdrawn, or, even further than that, whenever capital ceases to flow from England to other countries. England gets its money on interest and dividends on capital invested in foreign countries for freight earned by its shipping interests, for insurance premiums, and for services rendered by its acceptance houses and banks, and generally

for financing by its enormous credit facilities the industries of the world.

"Our situation is different. We are a debtor nation. We owe England for those services, and gold naturally, therefore, flows from us to England, excepting in so far as she either takes our commodities or buys our securities. We have been losing gold steadily since the beginning of this war. The net amount of gold exported so far is $140,000,000 and a great deal more will no doubt go out gradually.

"The bearing of all this on the question that is before the Commission here—rates—is this: If we cannot get England to see that our securities are good, we may be able to supply, to some extent, the money with which to pay our debts by contracting new debts. We owe England now about 250 million dollars.

"Now, the situation so far as England is concerned is this: It has withdrawn its capital from the markets of the world. Mexico was already in default before the war began. Brazil was in default, for the reason that English capital has ceased to flow there. They are over-expanded.

"There is a great danger, more than a likelihood, even, of Argentina, and probably Chile, defaulting. Canada is in a very bad way. They may have to be financed as an emergency measure by England. England has financed the weaker governments of Europe. It has financed all its own corporations. It has guaranteed bank loans to the extent of 80 millions sterling, $400,000,000. It has guaranteed all the acceptances due before the moratorium was created, by reason of the fact that foreign debtors, either belligerents or even neutrals or allies, that could not pay, were unable to meet their obligations through their acceptance houses. The moratorium will cease in a few weeks, and the British Government has further guaranteed to stand back of the post moratorium acceptances. All of this has resulted in keeping the trade of the world going for our benefit as much as for anyone's else. Of course, England is doing it primarily for her own.

"The great danger that lies before us is this: Up to the present time there has been a large investment in American securities abroad. The figures, Sir George Paish tells me, are, conservatively, six thousand million dollars. not a lesser amount, and the very large predominating majority of those are railroad securities.

"Sir George Paish thinks that England should continue to buy American securities, for the reason that, strange as it may seem, as he says, the greatest danger is by these defaults of the world over—Brazil, Argentine, Canada and Mexico, with a possibility of further defaults—the European investor may become so panic-stricken in regard to his investments that he will begin to hoard and the gold will disappear. If that happens, of course the whole civilized world is going to collapse immediately, so far as credit is concerned.

"If, however, American railroad securities will be accepted by the European investor as the one thing in which his savings are safe, the one thing that he can turn to, the great railroad trade of the world, which means most of our trade, because, while

our trade has diminished, it will gradually increase, and even though less than formerly, it will be a large proportion of the world's trade—if such security can be created, giving British investors thorough confidence that the American railroad security is the only thing that offers him protection, the effect upon this country is going to be magical, whereas the opposite opinion would be disastrous.

* * * *

"I believe that the mere granting of a 5 per cent. increase in Official Classification Territory will produce a very important effect in this respect, that it will cause the European and American investor, both, to believe that, in time of great emergency, the Interstate Commerce Commission will extend whatever protection lies within its power to the railroads to maintain their credit, and leave it to the future, if earnings under that ruling increase beyond reason, to make whatever reduction is then deemed wise and just, and if such a reduction be then made, I think it would produce a great deal more of confidence because the investor would know that at a time of emergency he would be protected.

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"The standard securities of this country are railroad securities. It is only within the last ten or fifteen years that industrial securities have become partly standardized and the subject of investment. To the extent that railroad securities are the standard securities, it is, of course, true that in any panic, in any great emergency, whatever threatens railroad securities will threaten others; but, in the first place, that is a diminishing tendency, and, in the second place, at a time of that sort things usually run their course.

"The ordinary remedies, heroic, sometimes cruel, are sufficient. Losses are taken and the individual who loses suffers; but the country at large does not suffer Matters right themselves. They run their course. That happened in 1907 It took place in the worse panic of 1890 to 1893, in the period of the Silver agitation; but this is a thing so appalling, so vast, of such tremendous consequences.

"The new fact that the British Government should guarantee hundreds of millions of sterling for obligations of individuals is a better indication of the general situation than anything I could say.

"Both as a matter of self-interest to the railroads and to the public, if money has gone honestly and with reasonably good judgment into a property the rates of which are regulated by public authority and over which the management has no control, so that its profits are more or less limited, I do believe any investor has a right to expect, broadly speaking and not taking individual cases, that he shall have a continued return upon that investment.

"He has not the opportunity to get, neither has the management to give him, extraordinary big profits in good years to compensate him for diminished profits in bad years. It has become, under Government regulation, a question of Government protection; not a guarantee, but certainly

Government regulation implies Government protection, and the failure to give it is going to result in the nationalization of railroads, because the money will not be forthcoming.

"It is a dynamic question. If confidence does not exist, can you get the capital? If, then, the investor has to take his chances of all the fortunes of good and bad business, war and peace, regulation of wage questions—because the stoppage of a group of railroads is of national importance—the caprices, or, perhaps that is not the word, the judgment of tax commissioners of various States—if he has to take all those chances and then is not going to be allowed to make 8 or 10 or 12 or 15 per cent. in good times to compensate him for the lack of dividends or the diminishing of dividends at other times, you will find the money will not be forthcoming.

"As this matter is committed to Government regulation, and wisely committed, I think, the Government must extend to the investor a protection beyond that which it extends to any other industry, not as a matter of moral right—I am not discussing the question from that point of view—but as a practical question as to the result.

"Of course, if it is the opinion of this country that we should have Government ownership, that ought to come as the result of a full and frank discussion, so that the public may make up its mind, and not as a by-product or an accident of regulation.

"That regulation has resulted in not getting the capital, and hence the Government must step in to take over the railroads. If the policy of Government ownership is a wise one, it ought to come as a matter of popular discussion, so that the public sentiment could be on record on the subject.

* * * *

"It may be thought by those who take a narrow view of the subject that it is not a part of the duty of the Interstate Commerce Commission to concern itself with the prices of stocks or bonds. Whatever may be true in ordinary times, and in my judgment the Interstate Commerce Commission can never safely ignore this factor, under present conditions of stress and strain it is certainly the duty of the Interstate Commerce Commission to do everything in its power to prevent low prices of railroad and, indirectly, therefore, of other securities.

"And I say 'other securities' because the prices of other securities almost invariably take their tone from that of railroad securities. These furnish the standard of prices. If the prices of railroad securities are depressed, so will be those of other industries.

"The country cannot prosper unless the railroads prosper. This is axiomatic; but at the present time it is truer than ever before. It is needless to point out that corporations seeking to finance themselves cannot sell their securities at prices above the market. It is, therefore, distinctly to the interests of all the people of this country, shippers and travelers and others, that the Interstate Commerce Commission should do everything in its power to maintain a high level of prices for railroad securities.

"It may seem to the Commission that

this is a very much overdrawn picture and that an increase of 5 per cent. in rates to be charged by the roads in Official Classification Territory cannot be the sole factor in determining whether this country is to proceed with the orderly re-establishment of its damaged credit and business structure, or whether everything is to go to ruin.

"This is unquestionably so; but it is also true that the other remedial measures which may be necessary are not within the power of the Interstate Commerce Commission to grant or withhold. Further remedial measures will in my judgment have to be undertaken, some by the banking interests of the country, some perhaps by the United States Government, and some by the State Governments and Public Service Commissions, but the only remedy that is within the power of the Interstate Commerce Commission to provide is a rate increase to the full extent asked for.

"Railroad securities have so far fallen into disrepute that even Receivers' certificates, until recently regarded as unassailable investments, have in some cases been renewed only by means of forced extensions.

"The crisis is immediate and the remedy must be immediate also. It is of no use now to speak of economies of operation. These should be undertaken and must be undertaken in due course. Immediate relief, in part, lies within the power of the Commission to grant, and this, in my judgment, it ought to grant in order to re-establish confidence in American railroad securities and to check the further export of gold.

"If in better times and under other conditions the increased rates now asked for should be found to be too high, it is within the power of the Interstate Commerce Commission then to order a reduction as it is now within its power to grant an increase."

Increased Rates Needed Because of Fundamental Unsoundness of Railroad Industry

WASHINGTON, D. C.,
October 23, 1914

Mr. Samuel Rea, President of the Pennsylvania Railroad System, in testifying today before the Interstate Commerce Commission in the matter of increased freight rates, said:

"The railroads have appealed to the Commission to modify the order made last July, because since then certain facts have transpired and certain events have occurred, in the light of which the present situation of the railroads should be judged. We consider this situation a sufficient reason for the Commission to grant what the railroads ask.

"Among these new factors are:

"First—Complete figures covering the financial results for the fiscal year 1914, which are now for the first time available in this case; also statements of operation covering the months of July and August of the present fiscal year.

"Second—The European War.

"The Commission had before it, at the time the hearings were closed, figures from which it made an estimate of the operating results for the twelve months ended June 30th last. The Commission in its report

took cognizance of figures covering eleven months of the twelve, as far as certain operating results were concerned, but in another, and a much broader sense, the complete 1914 results, showing as they now do the return on the investment, are new and of the greatest significance in connection with this petition. The Commission did not have, and could not have had before it, at the time it made its report in this case, the information necessary for it to appreciate fully the conditions of the transportation industry as now disclosed in these complete returns.

"In the fiscal year 1914 the decrease in the volume of business of these carriers was only about 3½ per cent. from the highest level in their history, viz., in 1913. Yet at the end of 1914 the owners of these properties find the return upon their property investment at the lowest figure for fifteen years, lower than in 1900, when the industry was lifting its head after the great depression of the nineties; lower, indeed, than in the two years 1898 or 1899, which the Commission in its recent report excluded from comparison on the ground that those were years of business depression. A record such as this clearly indicates something radically wrong with the underlying conditions of the railroad business.

"The Commission in its report recognized the need for more revenues for these carriers. The complete 1914 financial returns clearly indicate that this necessity has now become vital.

"The operating returns for July and August add to the seriousness of the situation. For those two months the decline in gross earnings averages about 6 per cent. as against a

loss of less than 3½ per cent. for the entire year 1914. The companies have been compelled, by reason of this, to continue the forced retrenchment in operating expenses.

"That retrenchment policy and practice will not produce real savings in expenses or real increases in net profits, for sooner or later the property and equipment must be brought up to standard. It may be that since June 30th, as the result of drastic retrenchments, some railroads will show slightly better net operating results. Such apparent improvement is of little actual benefit. It must also be remembered that the railroads are continually increasing their investment in road and equipment, on which increase they should earn an adequate return.

"Such is what I conceive to be the immediate importance of the 1914 and later returns.

"With regard to the European war, the question has naturally suggested itself: In what respect may its effect upon the railroads be regarded as peculiarly justifying them in asking for relief? The war, it has been said, brings burdens for all. Why should not the railroads consider the burden that it brings upon them as one which they should themselves shoulder without seeking to be relieved therefrom?

"Had the railroads before the war been in a sound, healthy condition, it might have been claimed that in so far as their volume of business was temporarily affected thereby, that burden was one which the railroads should have assumed, just as they had previously borne the fluctuations that had occurred from time to time in their business resulting from industrial and commercial vicissitudes.

"The railroads, however, are subject to regulation by public authority covering not merely the rates they shall charge, but many of the conditions affecting their operating costs and methods; they are, and have been, placed in a category entirely distinct from that of industries not subject to such regulation. They should be in such a position of health that they could withstand their proper burden during a period of general adversity such as this, so that with an improvement in business they might be in a position to render a proper and adequate service, and earn a fair return on their property investment.

"In view of what the Commission before the war had found to be the basic condition of the railroad industry with reference to rising costs and inadequate returns, it must be admitted that the war has brought a special aggravation of a situation peculiar to the railroads: a situation which had already been adjudged as in need of relief.

"The conceded inadequacy in the net operating income of railroads in Official Classification Territory before the war resulted primarily from increased cost of maintenance and operation coincident with a large increase in property investment. On top of this the war has already caused a large increase in the rate of interest demanded by capital—how much it is hard to say with certainty, but we know that an enormous destruction of wealth is in progress, and that must have an inevitable effect on the supply of capital, and therefore on the rate of interest. Whatever increases the cost of capital increases the cost of transportation.

"The question here is not whether the

Commission shall advance rates merely in order to sustain security prices against selling by holders, abroad or at home, or even to continue dividends; although important, that is but one phase of a big question. This petition is for an advance in rates which it is hoped will result in enabling them to provide the proper facilities, improvements and service needed by the public, and earn an adequate return on property investment.

"The abnormal conditions brought about by the war affecting so directly the ability of any borrower to secure new capital, and requiring forcible reduction of all expenses and husbanding all resources, are strong reasons for remedying, at least in part, and doing so as quickly as possible, the fundamental unsoundness—war or no war—that had been previously shown to exist in the railroad industry.

"I feel that the existence of a crisis in the affairs of these railroads can no longer be questioned. Having earned a return of only 3.99 per cent. in 1914 on the property investment, with operating revenue progressively diminishing since the close of the fiscal year, with practically all improvement work suspended, with forces largely reduced, with passenger and freight train service curtailed, and maintenance of roadway and equipment deferred, this is a time for very definite and certain relief. I am convinced that in addition to whatever may be eventually realized from the methods for obtaining additional revenues suggested tentatively by the Commission, the situation is one that calls for positive and immediate treatment on the broadest possible scale within the powers of the Commission."

Opening Argument for the Railroad in Five Per Cent. Advance Case

WASHINGTON, D. C.,
October 29, 1914

That the returns for the year ended June 30, 1914, indicate that even before the war crisis there was "something fundamentally wrong with the railroad industry," was the text of the opening argument in the 5 per cent. rate case delivered before the Interstate Commerce Commission today by Mr. George Stuart Patterson, General Solicitor of the Pennsylvania Railroad.

The substance of Mr. Patterson's argument was as follows:

The carriers do not urge that the Commission should grant the relief which is asked for as a matter of grace. They do not claim that it is the duty of the Commission to increase rates on the general principle of promoting the prosperity of those industries whose prosperity is dependent upon the welfare of the railroads, regardless of whether or not the proposed rates are reasonable. The carriers recognize that it is the function of the Commission to determine what are reasonable rates, in view of all the circumstances of the case.

They do claim, however, that in this case they have shown the proposed rates to be just and reasonable in that these rates are required to supply a part of that inadequacy of the carriers' present revenue which has been found to exist and the existence of which is admittedly contrary to a sound public policy. They further urge that the plight of the railroads is one of the gravest dangers in the present situation, not only by reason of the vital importance to the community that its transportation machinery shall at all times be in a state of health and of efficiency, but also because railroad credit is the very backbone of the investment structure, now so gravely threatened by the present emergency.

For this reason they consider that nothing can be done more effectively to promote the welfare of the country as a whole at this time than to relieve, upon the broadest possible lines open to the Commission, trouble that is at the heart of the railroad industry.

* * * *

The Interstate Commerce Commission estimated in its former decision in the rate advance case that the 35 railroad systems in Official Classification Territory would probably earn "as low as 4.35 per cent." on their investment in road and equipment; the actual figures now available show that the return was 3.99 per cent., the lowest figure in the last fifteen years.

The complete returns for 1914 show for the 35 systems, in round figures:

An increase in total capital obligations of 159 millions of dollars.

An increase in property investment of 249 millions.

A *decrease* in operating revenues of 48 millions.

An increase in taxes of 3 millions.

A *decrease* in net operating income of 76 millions.

A *decrease* in dividends paid of 12 millions, and

A *decrease* in *surplus over dividends* of 84 millions, the surplus of nearly 76 millions in 1913 having disappeared and a deficit of 8 millions being shown in 1914.

The year 1914 showed the largest operating revenues per mile of first main track operated of any year in the fifteen that the Commission took for its review, with the sole exception of 1913. The operating revenue per mile of main track in 1914 was $23,466, whereas, in 1903 it was but $16,243. Yet net operating income per mile of first main track in 1914 was $4441, as against $4690 in 1903.

In other words, the entire growth of these systems in business and operating revenues between 1903 and 1914 has vanished in increased operating expenses and increased taxes, and $249 per mile additional has gone in the same way.

It is most unfortunate that the carriers should, while in such a condition of inherent weakness, be compelled to encounter a storm so serious as that which the war has brought upon the world.

* * * *

With reference to the suggestions of the Commission in its former decision as to how the carriers might obtain additional

revenue without a horizontal increase in freight rates, Mr. Patterson pointed out:

That many of the practices, such as storage, reconsignment, trap or ferry-car service, have been in existence for many years, and their curtailment or the imposition of additional charges will meet the bitter opposition of shippers generally, and will doubtless be made the subject of separate inquiry by the Commission.

That the tariffs filed by the carriers upon the recommendation of the Commission, cancelling "allowances" to industrial railroads, had been in some instances set aside by the Public Service Commissions of New York, Pennsylvania, Ohio and other States.

That the charges for "spotting" cars on Plant Railways, suggested by the Commission, had been suspended by the Public Service Commissions of New York, Indiana and Illinois, as well as by the Interstate Commerce Commission itself.

That the Western Trunk Lines had filed tariffs imposing additional charges for the trap or ferry-car service at Chicago, which charges have been suspended by the Interstate Commerce Commission, as well as by the Public Utility Commission of Illinois.

That there is no possibility of securing from these sources, in the near future, the relief which is so urgently demanded by the carriers.

* * * *

It is therefore submitted that a consideration of all facts, including those arising since the former hearing, show conclusively that the needs of the carriers can only be

met practically by the remedy of a general advance in freight rates.

Mr. Patterson closed with a quotation from the opinion of Commissioner Lane in the Western Advance Rate Case, as follows:

> "We do not say that the carriers may not increase their income. We trust they may and confidently believe they will. If the time does come when, through changed conditions, it may be shown that their fears are realized, or approaching realization, and from a survey of the whole field of operations there is evidence of a movement which makes against the security and lasting value of legitimate investment and an adequate return upon the value of these properties, this Commission will not hesitate to give its sanction to increases which will be reasonable."

This record shows that time to have arrived.

The Proper Rule for Determining the Claim for Increased Rates

WASHINGTON, D. C.,
October 29, 1914

Arguing in the Advance Rate Case before the Interstate Commerce Commission today on behalf of carriers in Central Freight Association territory, Mr. J. L. Minnis, General Solicitor of the Wabash Railroad, said in part:

"The carriers claim that all the tariffs which have not become effective should be approved and put in force, on the ground that they are in need of all the revenue the tariffs will produce.

"Now, what is the proper rule or measure for determining that claim?

* * * *

"The rule so often referred to by the Commission in previous cases, that a reasonable rate is one which will produce the legitimate outlay of the carrier and a reasonable return on the value of its property, is not appropriate or adequate in a case like the one we are considering, because it is inapplicable and contrary to

the policy of the Government to finance the railroad enterprise by private capital.

"In the first place, the rule does not measure the rights of the carrier. The rule had its origin in a case brought by a carrier to enjoin the enforcement of rates on the ground that they would confiscate its property in violation of the constitutional guarantees which vouchsafe to every man that his property shall not be taken without due process of law or for public use without compensation.

"Thus the rule was promulgated as a measure, not of the rights of the carrier, but as a measure of the rights guaranteed by the Constitution.

"Constitutional guarantees do not limit or define the rights of persons; they were designed to limit the extreme aggressions one may be forced to suffer.

"Thus the Constitution, as construed by the rule, guarantees that a carrier shall enjoy the right to produce its legitimate outlays and a reasonable return on the value of its property. But it may lawfully make more, and, according to the general understanding of equity and justice, it ought to be permitted to make more.

"The rule, then, is a proper measure of the rights guaranteed to the carrier, but not of the rights it may lawfully enjoy.

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"In the second place, the Constitution does not guarantee that the carrier will make enough money to defray its outlays and pay a reasonable return on its property; so, under the rule, investors in railroads may, at the utmost, make a reasonable return on their investments.

"I do not believe any one circumstance has been more harmful to railroad credit than the necessity which called for the application of that rule to protect the constitutional guarantees to the carrier, and the significance of the rule itself.

"Investors say, why invest our money in an enterprise which is forbidden the right to earn more than a return on our investments, without any assurance that it will earn any return whatever, and if it fails to earn a return during one period it has not the right to recoup our losses in the event it is able to do so, when we can invest our money in enterprises whose right to earn money is unlimited?

"The moral sense of right and justice of the investors has caused them to revolt, and will continue to cause them to revolt, against the suggestions that when they invest their money for the use of the public they must take all the chances and hazards, with a mere possibility of earning at the most a reasonable return on their investments, while the public who uses the product of the investment assumes no obligation or hazard whatever.

"Obviously, no man of sense will invest his money on the theory that he may, in case of necessity, take refuge under the constitutional guarantees to prevent the public from destroying his investment.

* * * *

"In the third place, the rule is an inflexible rule of law which measures an existing situation, and takes no account whatever of the future. It, therefore, does not admit of 'taking time by the forelock' or the

exercise of foresight in dealing with the needs of the carriers.

"Under it you cannot adjust rates to meet a foreseen change in transportation conditions which greatly enhances the cost of doing business, but you must wait not only until the foreseen event happens, but, as the rule has been applied, until your losses therefrom have continued a sufficient length of time to justify the certain belief that the changed conditions are permanent —and then the carrier may be allowed a reasonable return on its property, but nothing to recoup its losses.

"**No business can prosper or thrive under such circumstances, but in time must inevitably perish.**

* * * *

"In the fourth place, the Commission is an administrative body, created to administer the great railroad properties of the country. It differs from a court in this respect—that, whereas a court administers fixed and rigid rules of law without flexibility, the exercise of the powers of the Commission involves a flexibility limited only by the almost numberless exigencies which arise from time to time in the conduct of the railroad business.

"A judge applies his knowledge of the law, whereas the Commission must apply sound business judgment in the administration of great properties.

"In the fifth place, from the standpoint of the Commission, there is no means at this time of ascertaining the value of the property of the carriers—an ultimate fact indispensable to the application of the rule.

"The rule, therefore, in a case of this kind, not only fails to measure the rights of the carriers, but its application would be contrary to the policy of the Government, in that it would destroy the credit of the carriers and, in time, the railroad industry.

"My study of the question has convinced me that, as the Government itself is under a duty to its citizens to afford railroad transportation, and as it has adopted the policy to discharge that duty by depending and relying on private investors to furnish the money for that purpose, it must have engaged to make railroad investments reasonably attractive as the foundation of its policy, because a breach of that engagement would destroy the policy, either by depriving the people of transportation or necessitating its conduct by the Government directly.

* * * *

"When we consider that the credit of the carriers is now dependent on their revenues, the true rule would seem to be that the Commission ought to allow such advances in rates as, in the exercise of sound business judgment and foresight, the evidence shows reasonably necessary to make railroad investments sufficiently attractive to enable the carriers to obtain from private investors the money which they must have in order to afford facilities reasonably adequate for the transportation demanded of them by the public.

* * * *

"The inquiry, under the rule I have suggested, is whether the body of rates of the

carriers should be advanced in order to continue the policy of the Government to conduct and develop railroad transportation by private capital. And if it be found that an advance ought to be made for that purpose, the advanced rates would be reasonable, because reasonable rates, in view of the policy of the Government, could not, in the nature of things, be lower than a level of rates required to execute that policy.

"It will be noted that the rule imposes on the Commission the duty of not only exercising sound business judgment, but likewise reasonable foresight in the interest of the carriers.

* * * *

"If, under the legislation of Congress, the Commission has not the power to exercise the judgment and foresight which may be essential to enable the carriers to obtain the capital necessary to discharge their public duties, the Government has disabled itself from executing its policy and discharging its duty to our citizens, because, manifestly, the carriers have no power to exercise as a finality either judgment or foresight.

* * * *

"If the rule I have suggested be sound, the question then is, whether it is reasonably necessary and proper to make effective the proposed advanced tariffs in order to enable the carriers to finance their present needs and their needs in the future, which can now be foreseen, and that question must be determined on the evidence in the record.

"In my view, the determination of the question involves sound business judgment, based upon the results of the operations of the carriers up to the present time, the effect of the European war, in so far as it may be relevant, and the fact that the carriers must, within the next year, raise as much as 750 millions of dollars in order to meet maturing obligations and keep up their properties, and all other circumstances which may have a bearing on the case."

Why Coal Rates Should Be Increased

WASHINGTON, D. C.

In reply to the contention that there should be no increase in freight rates on coal, for the reason that the carriers had submitted no evidence relating specifically to coal rates as distinguished from the general body of rates, Mr. O. E. Butterfield, Assistant General Solicitor of the New York Central Lines, argued in substance as follows:

The observation of the Commission that larger cars must have reduced the cost of transportation is perhaps worthy of consideration in respect to coal, but that is no reason for saying that coal must be excepted from a general advance in freight rates made to replenish net revenues which have been found to be so low as to conflict with the public interest.

Cost is doubtless a factor to be considered in the determination of the question of the reasonableness of a rate, but it is not the controlling factor. This has been held by the Commission over and over again.

While the cost of the service may be and doubtless is a factor entitled to careful consideration in a case involving a single rate where traffic and commercial considerations are likely ultimately to control, in a case

like this, where an entire fabric of rates is involved, and where, as pointed out by Commissioner Prouty in the 1910 case, financial considerations are likely to control, the element of cost is of even less importance.

Much, if not most, of the increased property investment in the last few years has been induced by the desire to facilitate the movement of coal. The Magnolia Cut-off on the Baltimore and Ohio would probably never have been made had it not been for the desire of the Baltimore and Ohio to facilitate the movement of coal, and a finding that coal should be excepted from a general advance in freight rates is to ignore a multitude of influences making for higher cost, and particularly to ignore the additional investment upon which an additional return must be earned.

The carriers in this proceeding have proved their need for greater net revenue in the public interest, and the Commission, in view of that need in the public interest, has granted a very general advance in a portion of the territory.

The only reason given for the elimination from that general advance of the coal rates is the fact that larger cars have been used in the transportation of that commodity, tending to reduce the cost of such transportation. All considerations making for higher cost have apparently been overlooked.

The inadequancy of net revenue, which has been established by the carriers and found by the Commission, raises a presumption that the value of the service to the shipper has so increased as to justify

the elevation of the entire fabric of freight rates to a higher plane, leaving alleged unjust discriminations to be passed upon separately on the higher plane just as they would have been passed upon in due time on the lower plane.

Why Railroad Credit Should Be Maintained

WASHINGTON, D. C.

Arguing before the Interstate Commerce Commission on October 30th, on behalf of the carriers' application for an increase of 5 per cent. in freight rates, Mr. George F. Brownell, Vice-President of the Erie Railroad, said in part:

"We believe that had the conditions at the time of the former hearing been what they now are, the decision of the Commission would have been very different.

* * * *

"Among the new developments bearing upon the case is the great war, which was unforeseen when the former decision was made.

* * * *

"The credit facilities of the civilized world have broken down. Moratoria have been declared in many countries, stock exchanges have been closed, foreign exchange has been seriously disarranged, and the world's machinery of credit, international, national and corporate, is endangered.

"Wealth and property are being destroyed

upon an enormous scale. The price of capital has already materially increased, and will continue to increase. Securities have already declined to a disturbing extent, and there is grave danger of a further serious decline.

"The effect of the war on the supply of capital available for investment will inevitably be serious and great, it will materially increase the difficulty of the railroad companies in securing the new capital necessary for refunding, for improvements, and for other capital purposes, and will materially increase the cost of whatever new capital they may be able to secure for such purposes.

* * * *

"The demand for new capital will surely be much greater than the available supply. It inevitably follows that this great demand for capital resulting from the war and war loans will largely raise the rental price for the use of capital or interest rates, for many years to come, **and even then many who seek new capital will have to go empty-handed.** Already rates have largely risen, both at home and abroad. The new German loan bears 5 per cent. interest, and it is understood is being put out at less than par. In this country, rates for call money and commercial paper have risen to from 6 to 8 per cent., and borrowers of such undoubted credit as the city of New York, and one of the United States, have been obliged to pay as high as 6 per cent. or more for short time accommodation. Railroads such as the New York Central and the Erie have been unable to refund maturing short time notes, except by the

issue of other short time notes, and even then only with great difficulty and upon an interest basis of about 7 per cent. in the one case and about 8 per cent. in the other.

"It is clear that one of the effects of the war will be to raise the interest rates on investment securities much higher than it has been for many years, and that these railroads will have to pay, for any new capital they may be able to obtain, interest at a rate considerably higher than that paid by governments.

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"The suggestion has been made by counsel that the railroads can remedy their situation by curtailing or suspending dividends.

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"Curtailment of dividends would aggravate the situation, while suspension of dividends would make it increasingly difficult to obtain any capital, even by the sale of bonds. Total suspension of dividends by the railroads, though it would produce a panic, would not produce the amount of new capital required.

* * * *

"It is not contended by these carriers that the Commission have the power to, or should undertake to, approve rates that will be unjust or unreasonable, or that the Commission have the power to, or should undertake to, approve rates irrespective of their being just or reasonable, merely on the ground that such action would "stimulate business" or "restore confidence in the financial and business world," or accomplish any other such result, although such accomplishment might be very desirable in itself.

"I do, however, contend that in determining whether the carrier's charges for its transportation services are just and reasonable, the Commission have the right, and it is their duty to take into consideration, among other things, the adequacy of the net operating income derived therefrom, its sufficiency to enable the carrier properly to perform its important quasi-public functions, and to secure the new capital necessary therefor, and for the other related matters of public interest and welfare.

* * * *

"If there are several methods by which the Commission lawfully can enable the carriers to find relief from the existing inadequacy of their revenues, and one of these methods will also promote the welfare of, or safeguard public or private interests, while the adoption of the other method will either not accomplish that result or be doubtful in its effect, then I say the Commission should take these matters into consideration and should adopt the method of relief which will inure to the benefit of all.

* * * *

"That a crisis now exists in the affairs of these railroads, and that their credit, seriously impaired, as we believe, before the war started, principally because of inadequate operating income, is now confronted by a grave emergency, would seem to be but plain truths.

* * * *

"The crisis which confronts the railroads has been emphasized, has been aggravated and has been made more clear and certain by the war, but the war does not constitute and did not alone create the existing crisis in our affairs. That crisis existed before

the war and is reflected in the records of their operations and the long-continued increase in expenses and accompanying reduction in net revenues and income, whereby the railroad industry has been forced to become an industry of constantly decreasing returns.

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"In the majority report delivered by Commissioner Harlan on the former hearing, it was stated that the credit of our railroads has undoubtedly suffered in recent years, but that this was largely from causes that were independent of their rates. The majority were inclined to attribute this loss of credit and impairment of the confidence of the public in the stability of railroad securities largely to the mismanagement of some great railroad systems of international repute, to the circumstances leading up to the appointment of receivers for certain other companies, to the interlocking of railroad systems with weak lines, and other causes not related to the adequacy of rates or revenues.

"However, **upon the rehearing it now appears by the uncontradicted testimony of Mr. Strauss and others, that in their opinion and in the opinion of others who are best qualified to judge,** while the considerations referred to in the majority report have operated to a relatively slight extent, yet **the principal cause for the impairment of railroad credit and the impaired confidence in the value and stability of railroad securities has been the inability of the railroad companies to increase their rates to the extent necessary to secure to them reasonably adequate net revenues.**

"As stated by Mr. Strauss, this is the view entertained by Sir George Paish, an eminent British authority upon the subject, and similar views have been publicly expressed both here and abroad by Herr von Gwinner, the managing director of the Deutsche Bank of Berlin, and himself one of the most eminent continental authorities upon the subject.

"In January last the Bureau of Railway Economics requested the State Department to secure through our ambassadors to several European countries information with respect to rates and rate advances in those countries. Among the replies, copies of which were transmitted by the State Department to the Commission, was the cablegram of January 13th to the Secretary of State from Ambassador Gerard as follows:

> "'Average freight rate per ton, 1911, Prussian railroads, 1.213 cents; United States same, .757 cents; large eastern American lines less as Pennsylvania, .582 cents. Average compensation, Prussian railroad employes, four hundred thirty-seven dollars; United States same, seven hundred and twenty-five. Above statistics given me by director of Deutsche Bank, who says foreign investors' confidence in all American securities much shaken by hazardous financial situation, American roads, whose rates about one-half rates here have been reduced or are stationary while roads compelled to raise wages pay higher taxes and comply with many new regulations.'

* * * *

"In the early stages of this case there was presented to the carriers the prospect of large additional revenues other than from increased rates, such as extra charges for so-called free services to industrial roads, charges for the spotting of cars on industrial sidings, charges for lighterage and switching services in New York Harbor and elsewhere, and it was urged that the carriers could and should increase their revenues from such sources so as to render them adequate without resorting to increased freight rates.

"At the first sight the glitter of the profit it was thought might thus result to the carriers blinded the eyes of many. In the light of recent events we have a clearer vision, and now we realize again the force of the familiar truth that 'all that glisters is not gold.'

"The majority report of the Commission also made certain tentative suggestions as to measures which might be taken by the carriers to secure additional revenues and thereby 'to meet the situation' otherwise than by resorting to a general advance in their freight rates.

"As shown in the carriers' petition and by the evidence of Mr. Willard and other witnesses, the carriers have given and are giving earnest attention to the recommendations and suggestions of the Commission in those regards, but **one of the new factors in the case which we think the Commission should take into consideration is that the hopes of increased revenue from most of these sources, instead of having an early realization, will not end in fruition in time to afford a relief for the present situation**

and crisis, even though they happily may at some more remote period result in partial realization.

"It is believed by those responsible for the management of the carriers that they cannot safely rely upon any expectation that the additional revenues which may ultimately be secured by the adoption of means other than a general advance in freight rates can be obtained in the near future; or that when secured any such additional revenues will be adequate to meet the reasonable needs of the carriers for increased revenues in the present situation.

"It was pointed out by Commissioner Daniels in this case (p. 435) that while these suggestions offered at the close of the majority report as to methods of conserving and increasing railroad revenues are interesting and significant, many of them are more or less conjectural and most of them remote in possible effect, and that, inasmuch as the Commission is not constituted by law a board of general managers of the railroads of the country, these matters ought not to delay or postpone the settlement of the questions of law and fact involved in the proceedings.

"In Interstate Commerce Commission *vs.* Chicago Great Western Railway Co. (209 U. S., 118) the Supreme Court, speaking through Mr. Justice Brewer, says:

> "'It must be remembered that railroads are the private property of their owners; that while from the public character of the work in which they are engaged the public has the power

to prescribe rules for securing faithful and efficient service and equality between shippers and communities, yet in no proper sense is the public a general manager.'

* * * *

"We hope and believe that, upon all the facts which the whole record now contains, the Commission will find that the proposed rates are no more than just and reasonable and allow them to become effective, before it is to late; but in case the Commission determine to the contrary, should they not, in that event, as a matter of sound discretion (even if they are of opinion that the provision of the statute in that regard which I have quoted is not mandatory) adopt the course indicated by the statute, instead of requiring the carriers to await the outcome of the attempted application of the tentative suggestions as to substituted measures which might be taken by them to secure additional revenue? Would not that be the better, proper and safer course to pursue in such contingency—**particularly** in view of the fact that the carriers believe that what can be accomplished through such suggested substitute measures will be too inadequate in amount, and too remote in point of time, to provide necessary relief, and that the record justified that belief, **and in view of the further fact that the carriers, and the great public and private interests dependent upon their future welfare, otherwise would be subjected to the great risk of such alternative measures proving to be inadequate or ineffective?**

"It may be said that even conceding the correctness of the rule that the carrier is entitled to charge just and reasonable rates that will produce adequate revenues, it is difficult to apply the rule in practice, or to ascertain or in terms define it. It is true that the results cannot be determined with the ease and certainty of the application of a mathematical rule or the weighing of a commodity; but that affords no reason for abandoning a proper and logical rule, which is as definite as the constitutional guarantee that property shall not be taken without just compensation or without due process of law, or as the rules with respect to the taking of property by eminent domain. Though it were as difficult to express and define all the elements which constitute this standard as the star by which the mariner steers his ship is unattainable, it none the less affords as safe and sure a guide."

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